UNITED STATES DEPARTMENT OF AGRICULTURE
Rural Electrification Administration
Finance Division
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PREPARATION OF FINANCIAL STATEMENTS

Text No. 9

1. PREPARING STATEMENT FROM WORK SHEET

The preparation of the final statements from thw work sheet given in Text No. 8 will involve the rearrangement and classification of the data extended in the last two pairs of columns. The balance sheet is based upon the real elements and the profit and loss statement upon the nominal elements.

2. THE CLASSIFIED BALANCE SHEET

The balance sheets considered in Text No, 5 provided a classification of real elements under the main headings: Assets, Liabilities, and Capital. While such classification may be sufficient when there are only a few items, it is inadequate when the items are numerous. It then becomes necessary to group similar types of assets and liabilities under separate headings in order that the financial condition may be clearly and concisely shown. The necessity of subdividing the assets and liabilities in this manner will become more apparent after we have outlined the relationships existing among the various groups and the significance of these relationships from an analytical point of view.

Below is a classification of accounts which may be regarded as somewhat standard for balance sheet purposes, although it is by no means universally followed:

ASSETS	LIABILITIES AND CAPITAL
Current Assets	Current Liabilities
Deferred Charges	Deferred Credits
Plant & Equipment (Fixed)	Long-Term Debt (Fixed)
Other Assets	Net Worth (Capital & Surplus)

While a more detailed and extensive classification may be desirable, it is believed that the suggested grouping is sufficient for general purposes and should be followed whenever practicable, especially in the solution of problems where speed and accuracy are of paramount importance.

Although a general or typical type of balance sheet will be studied in this text, it is well for the student to become familiar with the REA balance sheet general classification of accounts given below:

ASSETS	LIABILITIES AND NET WORTH
Cash and Current Investments	Current and Accrued Liabilities
Current and Other Assets	Other Liabilities and Credits
Utility Plant	Net Worth

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3. CURRENT ASSETS

The items comprising this group are cash and other assets which, in the regular course of business, will be converted into cash within one year or less. Cash, marketable securities, and receivables are often called "quick"assets; inventories are called "working" assets. Examples of current assets are:

Current Assets:
- Cash
- Investments (temporary)
- Notes Receivable
- Accounts Receivable
- Accrued Income Receivable
- Merchandise Inventory
- Other Current Assets

Cash, of course, is the most liquid of all assets since it can be used for payment of debts or liabilities in its present form.

Short-term or temporary investments usually represent securities purchased with surplus cash during an off-season period. This excess of funds is invested in order to get the benefit of interest or dividend returns. When the money invested is again needed in the course of business operations, the securities are sold on the market and the proceeds used to meet current cash requirements. In valuing temporary investments for balance sheet purposes, the rule is: Cost or market, whichever is lower.

Notes receivable are written evidences of indebtedness. The maker promises over his signature to pay a certain sum of money at a specified or determinable future time. Notes receivable that mature within approximately one year from the balance sheet date are properly included among the current assets, Notes of affiliated companies however should not be included with customers' notes on the balance sheet. Inclusion as separate current assets is permissible only if the debtor concern is financially sound and can meet the obligation, upon maturity.

Accounts receivable represent the aggregate amount of claims against customers or other debtors for goods sold or services rendered on credit. As these claims are usually due within thirty to ninety days, they are always listed among the current items on the balance sheet.

Accrued assets, such as accrued interest on notes receivable, ordinarily will be converted into cash within a short time. Therefore, they form a part of the current items.

Merchandise inventory represents the value of all stock-in-trade remaining unsold at the end of an accounting period. There are several generally accepted bases for valuing inventories, the most common being: Cost or Market, whichever is lower.

In concluding this brief survey of current assets, it may be stated that the items comprising this group usually appear upon the balance sheet in the order of their liquidity for payment of current liabilities, beginning with cash and ending with the least liquid.

4. DEFERRED CHARGES

When an expenditure is made for services to be received or benefits to be accrued partly in the current period and partly in subsequent periods, a portion of the expenditure is applicable to expense of the current period and the remainder represents an asset value called a "deferred charge." Unexpired insurance premiums, prepaid interest, and development and survey charges fall under this caption. Deferred charges differ from current assets in at least two respects: First, they are ultimately converted into expenses--not realized in cash; second, they have little realizable cash value as a group; hence, the necessity for listing them on the balance sheet under a separate caption.

5. PLANT AND EQUIPMENT (FIXED ASSETS)

This classification includes those assets which are of a more or less permanent nature, intended to be used in the operation of a business and not expected to be converted into cash in the regular course of operations. The assets comprising this group, which generally have a life of more than one year, consist of such property as:

- Property Plant in Service
- Machinery and Tools
- Transportation Equipment
- Furniture and Office Equipment
- Structures & Improvements (Buildings)
- Construction in Progress (Additions to plant)
- Plant Purchased
- Land and Land Rights

All of the assets above except land and land rights are subject to depreciation and the value at which they are shown on the balance sheet usually is cost less estimated depreciation since date of construction or acquisition. Material as well as labor and overhead costs for construction work in progress should be reflected on the balance sheet under this heading and not as part of the inventories.

6. OTHER ASSETS

This general caption is provided to include those tangible or intangible assets that do not properly fall within any of the other groupings. These include goodwill, patents, franchises, trade-marks, etc., Long-term investments in bonds, stock, and other securities and property may also be found in this section.

Sometimes these items are grouped among the fixed assets. Although this procedure is not incorrect, intangible and permanent investments should if practicable be shown separately on the balance sheet.

Goodwill and other related intangibles falling within the same classification are usually valued at cost, which is the most practicable basis. Thus the value of goodwill arising from the purchase of a going concern would be determined by the excess of the purchase price over the sound value of the net assets acquired. It has been argued that extensive advertising, donations, and other expenditures which result in increased earnings are a proper charge to goodwill. The better view, however, is that such costs should be written off immediately, or when circumstances warrant, treated in part as deferred charges, and so captioned in the balance sheet. Goodwill actually paid for may not be written off, but may be carried on the books as an asset of permanent value.

Patents should be valued at actual cost less amortization since date of acquisition. These are written off by periodic charges to Profit and Loss over the period of the actual useful life, the maximum period being 17 years--the length of patent grants by the government. If a patent is developed, cost includes laboratory and experimental costs, legal expense and filing fees. It is not considered conservative accounting to show this type of asset on the balance sheet at its estimated resale value. The same principles apply in reflecting the value of facilities granted for a period of years, Trade-marks, chemical formulae, secret processes, etc. are also generally shown at cost, although some concerns write them down to $1.00 nominal value.

Business firms may have investments of a more or less permanent nature, such as land or land easements held for future exploitation; bonds for income purposes; and stocks of affiliated or competing concerns for purpose of income and/or control. While these items are similar to fixed assets in that it is not intended to convert them into cash in the immediate future, competent business authorities and reputable accountants prefer to list them under Other Assets; or if sufficiently important, they may be classified under the separate heading Investments. Long-term investments are ordinarily valued at cost on the balance sheet, unless a permanent decrease in value has been indicated, in which event they are written down to present value. When bonds are purchased at a price above par value, the accepted method of valuation is cost less amortization of premium to date.

7. CURRENT LIABILITIES

This group consists of various items of indebtedness which become due and payable within one year or less, for example:

Notes Payable
Accounts Payable
Accrued Taxes Payable
Accrued Wages Payable
Accrued Interest Payable

Current liabilities may be listed on the balance sheet in the order of their importance or maturity, those that fall due at an early date being placed ahead of those that are payable later. Payment of current liabilities will be made from cash and/or the proceeds of other current assets. Current liabilities generally are incurred in purchasing merchandise and borrowing money, or they represent unpaid expenses, such as accrued property taxes, social secuirity and unemployment taxes, interest accrued on borrowed money, and maturities of interest and principal on long term debts.

8. DEFERRED CREDITS

This heading will include liabilities which arise whenever money is received in the current period for services to be performed or goods to be delivered in a future period. Deferred credits bear a close resemblance to current liabilities. However, a current liability is discharged by the payment of cash whereas a deferred credit is earned by the rendering of services or delivery of goods. Deferred credits are ultimately converted into income. Examples include collections in advance for services to be rendered, rent, interest, subscriptions, fees, etc., A distinction should be made between deferred credits and such items as deposits which are refundable in cash only.

9. LONG-TERM DEBT (FIXED LIABILITIES)

Long-term debt and funded debt are fixed liabilities that run for a period of more than one year before they become due and payable. The items usually found in this group represent debts incurred to construct or acquire properties. these are known as mortgages payable, bonds payable, long-term notes payable, or obligations. It should be kept in mind that part of such fixed liabilities become current liabilities when their maturity date falls within a year from the date of the balance sheet and should be so classified unless speical provision for their payment has been made.

10. NET WORTH (CAPITAL AND SURPLUS)

The net worth section of the balance sheet is used to present the owner's equity in the enterprise. The items found in this section will depend largely upon the type of business organization under consideration, such as a sole proprietorship, partnership, or corporation. Regardless of the form of organization, one point should be emphasized: All the net worth accounts are grouped together on the balance sheet. In corporate accounting the accumulated undistributed balance of profit or loss of each accounting period are reflected in an account called "Surplus."

In the case of a sole proprietorship, two types of net worth accounts are usually found on the books: (1) The proprietor's Capital account, and (2) a Personal account or Drawing account. The Capital account is maintained for the purpose of showing the owner's investment in the business at the beginning of the accounting period. The Personal account, on the other hand, is established to reflect profits or losses, withdrawals, or additional investment of capital for the period. At the close of the fiscal period, the Personal account may show a debit balance or a credit balance depending upon whether or not profits were overdrawn. If this balance is regarded as an increase or decrease in the investment at the beginning of the period, it should be closed into the Capital account. In any event, the two accounts should be read together for balance sheet purposes and set up in the net worth section somewhat as follows:

I. C. Wren, Capital (beginning of period)		$25,000	
Net Income for the Period	$6,000		
Less: Withdrawals	2,400	3,600	$28,600

The reason for showing the net worth data in this manner is to itemize in detail the net changes in capital since the beginning of the fiscal period.

11. BALANCE SHEET ARRANGEMENT

A study of published balance sheets will disclose a lack of agreement in regard to the arrangement of the balance sheet subdivisions. However, the reader should adopt a single form as a basis for problem work. The one shown on pages 6 and 7 is suggested as practicable for general purposes. This statement has been prepared in report form from the work sheet illustrated in Text No. 8.

A point that deserves special consideration is the number of columns used. Ordinarily three are sufficient and the student will do well to limit the statement to that number. If more than three columns are used, the form becomes complex and is more difficult to prepare.

Jim Mann
BALANCE SHEET
As of June 30, 1944

ASSETS

Current Assets:			
Cash		$ 3,000	
Notes Receivable	$ 2,500		
Accounts Receivable	8,000		
Total	$10,500		
Less: Reserve for Uncollectible Accounts	105	10,395	
Accrued Interest Receivable		10	
Merchandise Inventory		2,400	$15,805

Jim Mann
Balance Sheet (Cont.)

ASSETS (Contd.)

Deferred Charges:			
Prepaid Insurance			$ 110
Plant & Equipment:			
Furniture and Fixtures	$1,000		
Less: Reserve for Depreciation	60	$ 940	
Building	$8,000		
Less: Reserve for Depreciation	180	7,820	8,760
			$24,675

LIABILITIES

Current Liabilities:			
Accounts Payable		$ 5,040	
Accrued Taxes Payable		80	
Accrued Interest Payable		30	$ 5,150
Deferred Credits:			
Unearned Rent Income			100
Long-Term Debt:			
Mortgage Payable			6,000

NET WORTH

Jim Mann, Capital at June 1, 1944		$12,970	
Net Income for the Period June 1 to June 30, 1944	$ 775		
Less: Withdrawals	320	455	$13,425
			$24,675

(See page 8 for illustration of this balance sheet in account form.)

Whether current items should appear first, taking precedence over the fixed items, is a matter of opinion. Some believe that the purpose for which the balance sheet is prepared should govern. Accordingly, a balance sheet prepared for credit purposes would begin with current items since bankers and other short-term creditors are interested primarily in the excess of current assets over current liabilities. On the other hand, a balance sheet prepared for investors would present the fixed items first since long-term creditors usually are interested in the relative amounts of fixed assets and fixed liabilities. The relative amounts of current items and fixed items are also a factor to be considered in deciding upon the arrengement of the balance sheet.

Another disputed point is whether deferred charges should be placed before or after the fixed asset and current asset groups. Some contend that inasmuch as certain deferred charges have no cash realizable value, they

Jim Mann
Balance Sheet June 30, 1944

ASSETS

Plant & Equipment:			
Furniture and Fixtures	$1,000		
Reserve for Depreciation	60	$ 940	
Building	$8,000		
Reserve for Depreciation	180	7,820	
Total Fixed Assets			$ 8,760
Current Assets:			
Cash		$3,000	
Notes Receivable	$2,500		
Accounts Receivable	8,000		
Total	$10,500		
Reserve for Uncollectible Accounts	105	10,395	
Accrued Interest Receivable		10	
Merchandise Inventory		2,400	
Total Current Assets			15,805
Deferred Charges:			
Prepaid Insurance			110
Total Assets			$24,675

LIABILITIES AND CAPITAL

Long-Term Debt:			
Mortgage Payable			$ 6,000
Current Liabilities:			
Accounts Payable		$ 5,040	
Accrued Taxes Payable		80	
Accrued Interest Payable		30	
Total Current Liabilities			5,150
Deferred Credits:			
Unearned Rent Income			100
Total Liabilities			$11,250
Net Worth:			
Jim Mann, Capital June 1		$12,970	
Net Income for Month	$775		
Less: Withdrawals	320	455	13,425
Total Liabilities and Capital			$24,675

(Illustration of balance sheet in account form)

should be the farthest removed from cash, others hold that many of these items are used in place of cash to meet future expenses and, therefore, deferred charges should follow the current asset group. With regard to deferred credits, some hold that these involve a certain reduction of current assets and should follow the current liability group; others hold that deferred credits are more closely related to capital and, therefore, should precede the net worth section.

In view of varied opinions, the most that can be said definitely is that whatever order is adopted for the assets should be consistently followed with respect to the liabilities. If fixed assets are placed first, fixed liabilities should be placed first; if deferred charges are placed second, deferred credits should be placed second, and so on.

Regardless of the group arrangement, balance sheets are prepared in either of two forms: the account form and the report form. The report form is easy to prepare when a typewriter is used. The account form is found in many published reports, assets being placed on the left side of the page, and liabilities and capital on the right side. The account form of balance sheet showing fixed items first—an arrangement not infrequently used—is illustrated on page 8.

12. BALANCE SHEET ANALYSIS

The primary reason for classifying assets and liabilities in the balance sheet is to enable those interested in the financial condition of an enterprise to interpret easily the information. In studying a balance sheet it is necessary to consider not only individual items but also groups of related items. These groups bear a relationship to one another which tends to reflect certain important financial conditions. A balance sheet should be prepared in sufficient detail to permit ready analysis.

The analysis of a balance sheet involves application of ratios concerning the various groups of accounts. Without attempting to exhaust the problem of balance sheet analysis, it may be worthwhile to mention a few of the more important ratios which receive attention from persons interested in the financial affairs of a business.

Current Assets and Current Liabilities

The net working capital of a business is the excess of current assets over current liabilities. Jim Mann's working capital is $10,655 ($15,805 minus $5,150). If working capital is too small, short-term borrowing may be necessary. An excessive working capital, however, may indicate idle funds tied up in inventory or receivables.

The working capital ratio is more important from the creditors' viewpoint. This ratio of current assets to current liabilities is also known

as the "current" ratio. It indicates the margin of safety for current creditors and the promptness which they may anticipate in the settlement of their claims. From the balance sheet of Jim Mann note that the ratio of current assets ($15,805) to current liabilities ($5,150), or the working capital ratio is 3 to 1. For a small trading concern this would be considered satisfactory.

A ratio as low as 2 to 1 usually indicates ability to meet the claims of creditors of short-term obligations as they mature, providing the cash position is also satisfactory.

Plant & Equipment and Long-Term Debt

This relationship is important because if the ratio is better than 2 to 1 a reserve financial strength is evident. Reduction in the values of plant and equipment may occur without endangering the interest of long-term creditors or, if necessary, funds could be raised through bonds or mortgage notes. The balance sheet of Jim Mann shows fixed assets $8,760 to mortgage payable $6,000, a ratio of less than 1.5 to 1. Curtailment of at least a part of the mortgage indebtedness would seem desirable.

Net Worth and Total Liabilities

This ratio is of importance because it shows the proprietor's capital risk as compared with that of outsiders. A low ratio of capital to liabilities may be either an advantage or a disadvantage, depending upon conditions. If a business is prosperous it may mean that the owner is reaping a large return on his investment. On the other hand, if the business is in adverse circumstances, it may indicate that insolvency is imminent or that no return is being realized on invested capital. During a period of business depression a concern with a low percentage of invested capital to liabilities may not survive owing to the necessity of meeting current maturing obligations. In the case of a sole proprietor, banks usually require that the invested capital be greater than the borrowed capital. The net worth of Jim Mann, $13,425, is 1.2 times his total liabilities, $11,250.

Other ratios between balance sheet items may be developed, but those given above are most common. The percentage of each item (and each group of items) to total assets, or to total liabilities and capital, frequently is given. For comparison, both opening and closing balance sheet values may be presented on one statement. The ratios that may be computed from balance sheets and the profit and loss statements are too numerous for discussion. The analysis illustrated emphasizes the importance of properly grouping the various data found on a balance sheet.

13. THE PROFIT AND LOSS STATEMENT

A comparison of the balance sheets at the close of two successive periods will disclose the net increase or decrease in capital during an accounting

period. Such a comparison, however, fails to reveal the factors responsible for this increase or decrease. It may be said, therefore, that the purpose of the profit and loss statement is to present in detail the results for the period as shown in the net worth section of the closing balance sheet. In this regard the profit and loss statement may be considered a schedule which emphasizes a definite item on the balance sheet; namely, "Net Income (or Net Loss) for the period."

As previously stated, the preparation of a profit and loss statement involves a rearrangement of the nominal accounts appearing on the work sheet. Not only should the individual items of income and expense be shown but, as in the case of the balance sheet, these items must be properly classified and grouped so that anyone who reads the statement may get a clear and intelligible understanding of what has taken place as the result of operations during the accounting period.

14. CLASSIFICATION OF NOMINAL ACCOUNTS

The profit and loss statement may be divided into two broad divisions: (1) Operating section, and (2) the Non-Operating section.

The operating section of a profit and loss statement--although it bears no separate and distinct caption--embraces all the elements of income and expense pertaining to the regular operations or principal functions of the business. Accordingly, the operating section of the profit and loss statement for a mercantile business would contain all the nominal accounts connected with the purchase and resale of merchandise; for a brokerage concern, income from commissions and expenses connected therewith; for a bank, interest earned together with the expenses incident to earning this class of income; for REA electric cooperatives, revenue from electric energy sales and related operating expenses.

The non-operating section of the profit and loss statement contains only those elements of income and expense which are not connected with the principal activity of the business. Under this heading would come unusual gains and losses and those items of income and expense that are merely incidental to the major function of the business. Examples drawn from a trading business would include: Loss or gain on sale of temporary investments, interest on bonds owned, dividends on stocks owned, interest on accounts and notes, rental income, and so on. For a trading concern, financial income or expense is merely incidental while other extraordinary items usually are non-recurring. In the case of REA cooperatives, non-operating revenues include interest from notes receivable and revenue from sales of materials held for resale. Non-operating revenue deductions would be interest on notes payable and long-term debt and cost of sales of materials held for resale.

15. SUBDIVISIONS OF THE OPERATING SECTION

The order and grouping of income and expense data as ordinarily found in the operating section of the profit and loss statement prepared for a trading concern is as follows:

Net Sales	xxx
Cost of Goods Sold	xxx
Gross Profit on Sales	xxx
Operating Expenses	xxx
Net Operating Profit	xxx

The principal purpose of this arrangement is to portray the most important facts concerning the business operations for the period under review.

It will be noted that the main source of income is indicated first. In the case of a trading concern this would be the amount received from sales. The gross sales figure is reduced by deducting the related accounts, such as Sales Returns and Allowances. The resulting figure is Net Sales.

The next item to be considered is the Cost of Goods Sold. This figure makes it possible to compare the purchase prices of merchandise with the price for which it is sold. It also makes possible the computation of an important ratio known as "inventory turnover"--the cost of goods sold divided by the average inventories for the period. This ratio discloses the extent to which inventories are being converted into receivables or cash. If relatively high, it may indicate good management; if too low, it may point to overstocking or inadequate sales. The cost of goods sold may be shown in the profit and loss statement as a separate item supported by a schedule, or the full computation may be set forth in the body of the statement as follows:

Sales		xxx	
Less: Returns and Allowances		xx	
Net Sales			xxx
Cost of Goods Sold:			
Opening Inventory		xxx	
Plus: Merchandise Purchases	xxx		
Less: Returns & Allowances	xx	xxx	
Plus: Freight & Cartage Inward		xx	
Goods Available for Sale		xxx	
Less: Closing Inventory		xx	xxx
Gross Profit on Sales			xxx

In this illustration the final result is gross profit on sales which forms the basis for an important percentage: gross profit divided by net sales. This ratio is significant because it shows whether or not the margin of profit on sales is adequate.

After gross profit on sales has been determined, the operating expenses are deducted therefrom to arrive at net profit on operations. If desirable, the classification "Operating Expenses" may be further subdivided according to the functional activities of the business, such as:

Gross Profit on Sales		xxx
Operating Expesnes:		
Buying Expenses	xx	
Selling Expenses	xx	
Delivery Expenses	xx	
General Administrative Expenses	xx	xxx
Net Operating Profit (or loss)		xxx

It should be understood that the detailed classification of operating expenses will vary with different forms of business enterprise and that the foregoing is intended to give only a general idea of expense classification.

16. SUBDIVISION OF THE NON-OPERATING SECTION

The non-operating section of the profit and loss statement follows the operating profit subtotal and usually is arranged as follows:

Net Profit On Operations			xxx
Non-Operating Items:			
Income:			
Discounts on Purchases	xx		
Interest Earned, etc.	xx	xx	
Expense:			
Discounts on Sales	xx		
Interest Paid, etc.	xx	xx	XX
			xxx

An alternative arrangement frequently found is given below:

Net Operating Profit		xxx
Other Income		
Discounts on Purchases	xx	
Interest Income	xx	
Dividend Income	xx	
Rent of Office Space	xx	xx
Gross Income		xxx
Deductions from Income:		
Discounts on Sales	xx	
Interest Expense	xx	
Repairs to Rental Property	xx	xx
Net Income for the Period		xxx

When the net effect of the non-operating items is subtracted from the net operating profit, the result is designated as Net Income or Net Loss for the period. The net results should agree with the corresponding item on the closing balance sheet.

The REA profit and loss statement, termed the "Statement of Financial Performance" has two major sections—the Statement of Income and the Detailed Statement of Expenses. In the first section total operating expenses are deducted from gross operating revenue, net non-operating revenue is added, and interest charges are deducted to arrive at net income. The second section lists in detail all operating expenses.

17. REPORT FORM OF PROFIT AND LOSS STATEMENT

The profit and loss statement, like the balance sheet, may be prepared either in the account or report form. Most accountants prefer to use the report form as it is easier to prepare when using the typewriter and is generally less difficult to understand. The discussion in this text, therefore, will be confined to the report form.

The following report form of profit and loss statement has been prepared from the work sheet in Text No. 8 and illustrates in a simple way the application of the principles outlined in the preceding sections. Notice that the operating section, leading to the amount of net operating profit, is not so titled. Some accountants divide this into two sections, the "trading" section showing gross profit on sales, and the "operating expense" section.

Jim Mann
Profit and Loss Statement
For the Month of June, 1944

Sales	$ 9,200	
Less: Returns and Allowances	150	
Net Sales		$9,050
Cost of Goods Sold:		
Opening Merchandise Inventory	3,000	
Purchases	7,000	
Freight and Cartage In	60	
Goods available for Sale	$10,060	
Less: Closing Inventory	2,400	7,660
Gross Profit on Sales		$1,390
Operating Expenses:		
Wages	$ 300	
General Expenses	150	
Insurance	10	
Depreciation	40	
Uncollectible Accounts	65	
Taxes	80	645
Net Operating Profit		$ 745

Jim Mann
Profit and Loss Statement (Cont.)

Net Operating Profit (brought forward)			$ 745
Non-Operating Income:			
Rent Income	$ 50		
Interest Income	10	$ 60	
Non-Operating Expenses:			
Interest Expense		30	30
Net Income for the Period			$ 775

Analyzing the above statement we find that the inventory turnover ratio is 2.84--cost of goods sold ($7,660) divided by average inventory ($2,700). This means that the average amount of goods carried in stock was sold 2.84 times during the month, or every 10.5 days.

Using net sales as a base, the following percentages may be developed:

Net Sales	100.00
Cost of Goods Sold	84.64
Gross Profit	15.36
Operating Expense	7.13
Net Profit	8.23

Sufficiency of the gross margin of 15% depends upon the type of business. The principal value of percentage analysis lies in comparison with like figures for past periods to determine trends in costs, expenses, and sales.

Another profit and loss statement, showing an alternative method of handling inventories and a detailed classification of operating expenses, is presented below:

Pat O'Brien
Profit and Loss Statement
For the Year 1944

Sales:		$79,450.85	
Less: Returns and Allowances		375.42	
Net Sales			$79,075.43
Cost of Goods Sold:			
Purchases		$51,625.60	
Freight and Drayage In		1,250.95	
Merchandise Inventory January 1	$10,805.10		
Merchandise Inventory December 31	10,369.35	435.75	53,312.30
Gross Profit on Sales			$25,763.13

Pat O'Brien
Profit and Loss Statement (Cont.)

Gross Profit on Sales (brought forward)			$25,763.13
Operating Expenses:			
Selling Expense:			
Salesmen's Commissions	$6,450.00		
Advertising	1,285.75		
Depreciation on Display Fixtures	200.00		
Miscellaneous Selling Expense	550.40	$8,486.15	
Transportation Expense:			
Wages of Delivery Force	$1,635.00		
Depreciation on Trucks	600.00		
Miscellaneous Delivery Expense	345.88	2,580.88	
General Administrative Expense:			
Office Salaries	$3,945.00		
Office Expense	290.37		
Depreciation on Office Equipment	38.50		
Rent	2,400.00		
Insurance	72.50		
Taxes	149.25		
Uncollectible Accounts	790.75	7,686.37	18,753.40
Net Operating Profit			$7,009.73
Non-Operating Income:			
Discounts on Purchases	$ 650.45		
Interest Income	95.60	$ 746.05	
Non-Operating Expense:			
Discounts on Sales	$ 300.90		
Interest Expense	45.50		
Loss on Marketable Securities	60.35	406.75	339.30
			$ 7,349.03

Bear in mind that a profit and loss statement is prepared for a period of time--shown in the heading--as distinguished from the balance sheet which is prepared as of a given date.

As in the case of the balance sheet, three columns usually are sufficient for the profit and loss statement. Needless to say, the form can be prepared with greater ease when limited to only three columns. Income statements frequently are published in condensed form and the detailed amounts entering into the computation of cost of sales, selling expenses, etc., are shown on accompanying schedules.